No. 17-961

IN THE

Supreme Court of the United States

THEODORE H. FRANK, ET AL.,

Petitioners,

v.

PALOMA GAOS, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

AMICUS CURIAE BRIEF FOR THE NATIONAL CONSUMER LAW CENTER AND U.S. PUBLIC INTEREST RESEARCH GROUP EDUCATION FUND, INC. IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICI CURIAE*[1]

The **National Consumer Law Center** is a non-profit research and advocacy organization that focuses on the legal needs of low-income, financially distressed, and elderly consumers. Founded at Boston College Law School in 1969, NCLC is a 501(c)(3) and legal aid organization that employs many attorneys and advocates with twenty or more years of specialized consumer law expertise.

NCLC has been a leading source of legal and public policy expertise on consumer issues for Congress, state legislatures, agencies, courts, consumer advocates, journalists, and social service providers for nearly fifty years. NCLC is the author of a twenty-volume Consumer Credit and Sales Legal Practice Series. NCLC has been a recipient of court-awarded *cy pres* funds as part of residual class action funds and uses these awards to protect the rights of economically vulnerable consumers through education, publications, policy analysis, and advocacy.

United States Public Interest Research Group Education Fund, Inc. ("U.S. PIRG Education Fund") is a 501(c)(3) independent, non-partisan organization that works on behalf of consumers and the public interest. Through research, public education, outreach, and litigation, it serves as a counterweight to the influence of powerful special interests that

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[1] Pursuant to Rule 37.3, all parties have consented to the filing of this brief. In accordance with Rule 37.6, counsel affirms that no counsel for any party authored this brief in whole or in part and that no person or entity other than *amici* made a monetary contribution to fund the preparation and submission of this brief.

threaten the public's health, safety, or well-being. U.S. PIRG Education Fund regularly participates as *amicus curiae* in cases that will have a substantial impact on consumers and the public interest, such as this one. U.S. PIRG Education Fund has been a recipient of court-awarded *cy pres* funds as part of residual class action funds, and it uses these awards to protect the interests of the public and consumers through research, policy analysis, education, and advocacy.

SUMMARY OF ARGUMENT

Amici submit this brief to provide their perspective on the importance of class actions and the *cy pres* doctrine for the effective enforcement of consumer protection statutes, and their importance to low-income consumers, in particular.

In our society, consumers engage in far more economic transactions than previously and do so with nationwide or regional companies using standardized forms, sales methods, and contracts of adhesion. To combat abuses in these practices and others, class actions continue to be essential.

The *cy pres* remedy serves an important role in consumer protection class actions. When direct distribution of all or part of a monetary recovery to class members is infeasible, the *cy pres* doctrine provides courts with an indispensable framework for distributing these funds in a way that benefits absent class members and consumers as a whole while also effectively serving the disgorgement and deterrence goals of consumer protection statutes. To prevent possible abuse, comprehensive and effective guidelines have been emplaced—chief among them

the American Law Institute's *Principles of the Law of Aggregate Litigation*—to govern the use of *cy pres* awards, thereby allowing them to prove a workable and advantageous distribution option for over a half-century.

In deciding this case, the Court should be mindful of the implications for low-income consumers of unduly hampering class actions, which constitute the most effective—and very often the sole—means of vindicating their rights as enshrined in consumer protection statutes. And the Court should be wary of unduly circumscribing the use of *cy pres* distribution because it is the next-best use of the funds recovered from such lawsuits, when direct distribution to class members is infeasible.

ARGUMENT

Class actions remain an indispensable mechanism for the effective enforcement of consumer protection statutes, and are of particular import for safeguarding the rights of low-income consumers. When the funds recovered from such lawsuits cannot be directly distributed to class members, the *cy pres* doctrine, in turn, provides courts with a framework for distributing them in a way that benefits absent class members and consumers as a whole while also serving the goals of the consumer protection statutes underlying the litigation.

In assessing the value of a given class action lawsuit, Petitioners focus almost exclusively on one criterion: monetary relief awarded directly to class members. They open their brief by asserting that they are challenging a settlement that "pays the class no money but instead directs millions to class

counsel and funnels the remainder to third parties." Pet'rs' Br. 1. They argue that a class action cannot be a worthwhile—let alone the *superior*—method of litigation unless monetary benefits will inure directly to class members. *Id.* 15; *see also id.* 52-54. Accordingly, rather than permit a next-best use of funds, they argue that if a court were to find that direct distribution to class members is infeasible, class certification is improper. *Id.* 10-11.

If restitution were class actions' sole purpose, Petitioners' arguments might be availing. But it is not. On the contrary, Petitioners ignore the "policy at the very core of the class action mechanism," which is to "overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights." *Amchem Prods. v. Windsor*, 521 U.S. 591, 617 (1997) (internal quotations and citations omitted). "A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor." *Id.*

In other words, Petitioners' approach would prohibit class action lawsuits in precisely those cases where they have been deemed essential: cases involving very small claims for individuals that, in the aggregate, involve substantial sums that will otherwise remain in the hands of the wrongdoers. Class actions—including those that involve *cy pres* awards—are thus the superior method of litigation for the enforcement of consumer protection statutes involving small individual damages. *See* Part A, *infra*.

Petitioners' myopic focus on individual recovery also overlooks—or perhaps willfully ignores—the other well-established policy purposes of consumer protection statutes that often form the basis of these suits: enhancing the fundamental fairness of the marketplace, deterring illegal conduct, and disgorging ill-gotten gains. When direct distribution to class members is infeasible, distributing *cy pres* awards to organizations working in the field of consumer protection indirectly benefits class members and better effectuates these purposes than do other options for the distribution of residual funds. *See* Part B, *infra*.

In short, prohibiting class actions simply because direct distribution is infeasible would disserve the very purposes of consumer protection statutes upon which these suits often are premised.

A. Class Actions—Including Those Involving *Cy Pres* Awards—Often Are Superior to Alternative Methods of Litigation for Protecting the Rights of Low-Income Consumers.

Class actions are critical in labor, civil rights, and many other contexts, but consumer claims provide perhaps the quintessential example of large-scale illegal profit-seeking behavior by companies that nevertheless does not financially harm any individual enough to induce litigation in the absence of the class action device. As one federal court put it, "[c]lass actions are often the most suitable method for resolving suits to enforce compliance with consumer protection laws because the awards in an individual case are usually too small to encourage the lone consumer to file suit." *Carr v. Trans Union*

Corp., 1995 U.S. Dist. LEXIS 567 (E.D. Pa. 1995) (class certified based on allegation of misleading debt collection notices). *See also Amchem Prods.*, 521 U.S. at 617 (discussing "negative value" suits).

Compounding the necessity of class actions to enforce many violations of these acts is the fact that low-income consumers, who are disproportionately their victims, are less able to bring suits on their own behalves. Class action lawsuits are thus vital tools for protecting the interests of these consumers. And indeed, they are the superior method of litigation in many cases.

When individual awards for consumer protection violations are not only so small that they do not provide an incentive for individual action, but are so small that they would be swallowed by the costs of distributing them—in other words, in those circumstances in which *cy pres* recovery may be triggered—the need for class actions to protect consumers' rights only is heightened.

1. Often, the "Alternative" to Class Treatment for Small Consumer Claims Is No Enforcement at All.

In theory, one benefit of the class procedure is its efficiency: adjudication of a properly constituted class action saves the resources of courts and parties by permitting an issue affecting numerous individuals to be litigated at once. In reality, a consumer class action rarely is filed to supplant numerous individual lawsuits. Rather, class actions are often the *only* economically viable way to provide legal representation for clients—particularly economically disadvantaged clients—with relatively

small claims. As Judge Posner succinctly, and colorfully, put it:

> The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30. But a class action has to be unwieldy indeed before it can be pronounced an inferior alternative—no matter how massive the fraud or other wrongdoing that will go unpunished if class treatment is denied—to no litigation at all.

Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004).

Indeed, for many consumers, entry into court itself proves an insurmountable barrier to vindication of their rights. For members of the armed service, for example, the realities of deployments, transfers out of the state where the courts have jurisdiction, and restrictions on their time often render the doors of small-claims courts (where these suits would likely be filed) effectively closed to them. And many low-income individuals cannot afford to forgo a day's wages to recover a lesser sum taken from them.

A class action—including one involving the prospect of a *cy pres* award because settlement funds cannot otherwise be economically distributed—is therefore the only realistic alternative, and it will nearly always be superior to no litigation at all. Consumer class actions for violations of the Servicemember's Civil Relief Act (SCRA), for example, have proved an important tool for enforcing

the economic rights of military servicemembers. *See, e.g., Olson, et al. v. Citibank, N.A.*, 10-cv-2992, 2012 WL 1231787 (D. Minn. Apr. 12, 2012) (preliminarily approving settlement agreement for monetary and injunctive relief in a class action alleging illegal mandatory forbearance on servicemember student loans under the SCRA). More broadly, without the legal restraint imposed by a lawsuit, a defendant that has acquired a sizeable windfall wrongly by illegally obtaining small sums of money from a large group of people will continue doing business in the future as in the past.

2. Class Treatment Is Also Superior to Individual Consumers Pursuing Claims in Small-Claims Court.

Even if some individual claims are filed in small-claims court—which will often be without the assistance of counsel—companies are apt to simply treat these small individual judgments as a cost of doing business. Companies may well continue to engage in the same illegal conduct with their other customers because there is no economic incentive to do otherwise.

On the other hand, class-wide judgment disgorges these unlawful gains, eliminating the profit-motive for the misconduct. Moreover, even the mere possibility of class-wide judgment can deter defendants from transgressing legal boundaries, before their doing so can harm consumers.

3. Class Actions Are Superior to Punitive Damage Awards in Small-Claims Consumer Protection Cases.

If small compensation class actions are discouraged, the only realistic alternative for achieving the deterrence goals of consumer protection statutes will be to seek large punitive damages awards on behalf of a few consumers who, while litigating relatively small individual claims, can prove willful, widespread misconduct by defendants. Nat'l Ass'n of Consumer Advocates, *Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 299 F.R.D. 160, 167 (3d ed. 2014).

This alternative is second-rate. First, the heightened "willful" standard is a more difficult and costly one to prove. More important, it frequently fails to capture injuries businesses cause through recklessness or negligence. Finally, even in those cases where punitive damages successfully extract large payments from defendants, using class actions to distribute *cy pres* awards is a better societal outcome. By distributing funds to appropriate charitable or public service organizations serving consumers in ways that are closely related to the underlying claims of the case, *cy pres* awards go one step further than punitive damages awards. They help to fund efforts to prevent the same harms from being perpetrated on future, similarly situated consumers, instead of providing relief merely to the few consumers who prevailed in their individual punitive damages claims.

B. *Cy Pres* Distribution of Residual Class Action Funds Best Effectuates the Purposes of Consumer Protection Statutes.

Consumer protection laws are meant to ensure that the choices given to consumers in the marketplace are unimpaired by fraud or withholding of material information, and that the power differential between consumers and commercial enterprises is equalized. *See* N. Averitt & R. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 Antitrust L.J. 713 (1997). They seek to improve the functioning of the marketplace by making it unprofitable to operate dishonestly. *Id.* And, of course, they seek to compensate consumers for the wrongs inflicted upon them.

Making all class members whole is the optimal outcome of any class action. Period. This case, however, concerns circumstances in which distribution to class members would not be possible. The three third-party options usually considered are: (1) escheat to the state, (2) reversion to the defendant, and (3) *cy pres* distribution. *See* H. Newberg, 2 Newberg on Class Actions §§ 10.13-10.25 (3d ed. 1992).

In consumer protection class actions, the underlying statutes' aims of promoting fundamental fairness in the marketplace, deterrence of fraud, and disgorgement of illegally obtained profits must be weighted heavily in making this determination. *Cy pres* awards, when the doctrine is applied as directed, are that next-best option. They benefit absent class members and consumers as a whole

while also fully effectuating consumer protection statutes' deterrence and disgorgement goals.

1. Escheat Falls Short by Failing to Serve the Consumers Harmed by the Consumer Statute Violation.

The escheat option (i.e., transfer of abandoned property to the state) generally fails to serve consumer protection statutes' goals to the fullest extent possible. Escheat can be broken into two categories: general and earmarked.

General escheat has been appropriately deemed "the least focused compensation to the class." *State of California v. Levi Strauss & Co.*, 41 Cal.3d 460, 475 (Cal. 1986). This option holds little promise of benefiting absent class members or those similarly situated, as the funds may be used for virtually any governmental purpose, with no attempt to realize the objectives of the underlying substantive law. *Id.* Moreover, it is lacking in deterrent power because it does nothing to support the efforts of those working to prevent similar conduct.

Earmarked escheat refers to an award of the funds toward a specific government agency in a position to assist citizens similar to the injured class. If used properly, this option can benefit consumers greatly and satisfy the deterrence and disgorgement goals with low administrative costs. It has been looked on favorably, but has rarely been applied. *See, e.g., Market St. Ry. Co. v. Railroad Commission*, 28 Cal.2d 363 (Cal. 1946). The reluctance of courts to rely upon earmarked escheats stems from concerns that the funds will be used for agency purposes

unrelated to the subject of the lawsuit and, therefore, not benefit class members or members of the public similar to them at all. *See* McCall, Sturdevant, Kaplan and Hillebrand, *Greater Representation for California Consumers: Fluid Recovery, Consumer Trust Funds, and Representative Actions*, 46 Hastings L.J. 797, 809 (1995).

2. Reverting Funds to the Defendant Frustrates Rather Than Serves Consumer Protection Goals.

Reversion of residual funds to the defendant is, of course, rarely an appropriate option, and Petitioners do not propose it—at least not directly. Reversion is inappropriate because it neither compensates class members nor satisfies consumer protection goals. Rather it allows the defendant, the alleged wrongdoer, to keep the fruits of its wrongdoing. *See In re Motorsports Merch. Antitrust Litig.*, 160 F. Supp. 2d 1392, 1394 (N.D. Ga. 2001). *See also In re Wells Fargo Secs. Litig.*, 991 F. Supp. 1193, 1196 (N.D. Cal. 1998); Am. Law. Inst., *Principles of the Law of Aggregate Litigation* § 3.07 cmt. B (2010) (rejecting reversion because it would "undermine the deterrence function of class actions"). Reversion is only appropriate in limited cases where the defendant acted in good faith, and/or when punitive damages are disallowed pursuant to statute. *See, e.g., Wilson v. Southwest Airlines, Inc.*, 880 F.2d 807 (5th Cir. 1989) (an example of appropriate reversion in a Title VII action).

Curtailment of class action certification along the lines Petitioners propose would not be reverting funds to defendants but rather never requiring

defendants to hand over their ill-gotten gains in the first place. This is because the likely consequence of discouraging these actions, as discussed in I.A.1, *supra*, is to discourage the only realistic form of litigation for challenging this misconduct when it inflicts injuries to individuals too small to rationalize non-collective action.

3. *Cy Pres* Distribution Often Best Effectuates Purposes of Consumer Protection Statutes.

The final option is *cy pres* distribution, the primary purpose of which is to serve as a deterrent to would-be wrongdoers and to enable the effective enforcement of the policies underlying the cause of action. It does so by helping to fund organizations that work to prevent the same wrongs from being perpetrated on future consumers, and redressing those wrongs when they do, inevitably, recur.

Petitioners discount—nay vilify—this option. Rather than permit funds to be distributed to entities serving the relevant interests of class members, they argue that if a court were to find that distribution to class members is infeasible, then no class should be certified in the first instance. Pet'rs' Br. 10-11. But, as discussed throughout this brief, restitution is not the sole aim of class actions or consumer protection statutes, and *cy pres* awards can help realize and amplify the various other benefits that consumer protection class actions achieve.

By providing a mechanism through which to furnish an indirect benefit to non-claiming class members, as well as deter misconduct and disgorge

wrongful gains, *cy pres* distribution often provides the ideal solution for distribution of residual funds. *See Mirfasihi v. Fleet Mortgage Corp.*, 356 F.3d 781, 784 (7th Cir. 2004) (noting that the *cy pres* doctrine is utilized to prevent defendants "from walking away from the litigation scot-free because of the infeasibility of distributing the proceeds of the settlement . . . to the class members").

Moreover, to prevent possible abuse, appropriate guidelines have been put in place to govern the use of *cy pres* awards, allowing these awards to prove a workable and advantageous distribution option for over a half-century. Appellate courts overwhelmingly have adopted the American Law Institute's *Principles of the Law of Aggregate Litigation*, *supra* § 3.07,[2] which provides guidelines on the limited circumstances where *cy pres* distribution is appropriate, including standards regarding appropriate recipients, and neither Congress nor the Rules Advisory Committee have found reason to diverge from these well-functioning principles. *See* Class Resp'ts' Br. 9-11, 31-35. In consumer protection class actions, in particular, finding a worthy *cy pres* recipient—namely, one who will promote the interests of the class of consumers and the purposes of the statutory prohibitions underlying the litigation—is made easier by the array of reputable organizations working in the consumer protection sphere.

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[2] NCLC participated in the drafting of—and adheres to—the National Association of Consumer Advocates (NACA) *Standards and Guidelines for Litigating and Settling Consumer Class Actions*, *supra*. Guideline 7 of these guidelines closely follows § 3.07 of the American Law Institute's *Principles of the Law of Aggregate Litigation*.

For all of these reasons, allowing residual funds to be distributed via *cy pres* awards fulfills these funds' next-best use, when direct distribution is not possible.

CONCLUSION

The National Consumer Law Center, on behalf of the low-income consumers who are its clients, and U.S. PIRG Education Fund urge the Court to be mindful of the effects its decision in this case will have on enforcement of consumer protection statutes, and the consequent impact on the low-income consumers who are too often the victims of transgressions of these laws.

Respectfully submitted,

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